

Message Text

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LAB-04 SIL-01 /117 W
-----231811Z 058755 /53

O R 231709Z MAR 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 1878
TREASURY DEPT WASHDC IMMEDIATE
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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD MARCH 17 - 23

SUMMARY: ON THE EVE OF THE CRUCIAL COMMONS VOTE OF CON-
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FIDENCE, FOREIGN EXCHANGE MARKETS BECAME SOMEWHAT UNSET-
TLED. HOWEVER ECONOMIC INDICATORS TOOK ON A MORE UPBEAT
TONE. GDP ROSE BY 1 PERCENT IN THE FOURTH QUARTER OF 1976
WHILE RETAIL PRICES WERE RISING IN FEBRUARY LESS THAN HALF
AS FAST AS THEY HAD IN JANUARY. UNEMPLOYMENT FELL FOR THE
SECOND MONTH IN MARCH WHILE THE RATE OF INCREASE IN WAGES
AND EARNINGS CONTINUED TO SLACKEN. THE MONEY SUPPLY DE-

CLINED FOR THE THIRD CONSECUTIVE MONTH GIVING FURTHER ASSURANCE THAT THE FY 76/77 M3 GROWTH RATE TARGET OF 9 - 13 PERCENT WILL BE ATTAINED. IN THEIR ANNUAL ECONOMIC POLICY REVIEW, CAMBRIDGE UNIVERSITY ECONOMISTS RENEWED THEIR CALL FOR IMPORT CONTROLS COUPLED WITH HIGHER GOVERNMENT SPENDING AND LARGE TAX REDUCTIONS AS THE ONLY VIABLE LONG-TERM MEANS OF REDUCING UNEMPLOYMENT. END SUMMARY.

1. STERLING HAD AN UNSETTLED WEEK, PROVOKED BY MRS. THATCHER'S CALL FOR A VOTE OF NO CONFIDENCE LAST THURSDAY. ON FRIDAY AND MONDAY STERLING WAS PARTICULARLY ACTIVE ON SALES FROM THE U.K. RATHER THAN FROM SELLING PRESSURE IN OTHER MARKETS. THE BANK OF ENGLAND GAVE SUBSTANTIAL SUPPORT TO THE MARKET ON MONDAY MORNING, BUT COMMERCIAL ORDERS FROM NEW YORK REVERSED THE DOWNWARD TREND. MARKETS WERE FAIRLY CALM TUESDAY AND WEDNESDAY MORNING. SELLING PRESSURE SINCE MONDAY AFTERNOON TERMED RELATIVELY SMALL, THE ABSENCE OF BUYING BEING PERHAPS THE MOST NOTABLE FACTOR WITH CONTINENTAL OPERATORS TAKING A WAIT AND SEE ATTITUDE PENDING OUTCOME OF THE VOTE OF CONFIDENCE (SEE LONDON 4627).

2. THE BROADLY DEFINED MONEY STOCK M3 FELL FOR THE THIRD CONSECUTIVE MONTH. THE STERLING COMPONENT OF M3' THE MONETARY AGGREGATE UPONWHICH THE MOST ATTENTION HAS BEEN FOCUSED SINCE THE IMF NEGOTIATIONS, FELL BY 0.7 PERCENT TO 39.320 MILLION POUNDS (SEASONALLY ADJUSTED) IN THE BANKING MONTH ENDED FEBRUARY 16. TOTAL M3, WHICH INCLUDES FOREIGN DEPOSITS HELD BY U.K. RESIDENTS, FELL BY 0.3 PERCENT (SEAS-

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ONALLY ADJUSTED). STERLING M3 (S.A.) NOW STANDS ONLY 5.3 PERCENT ABOVE ITS LEVEL OF MID-APRIL 1976.

THE NARROWLY DEFINED MONEY STOCK M1 ROSE BY 1.3 PERCENT, S.A. DURING THE FEBRUARY BANKING MONTH. THIS SERIES IS PARTICULARLY ERRATIC, PERHAPS AS A RESULT OF FREQUENT SHIFTS BETWEEN STERLING SIGHT AND TIME DEPOSITS.

THE ASSETS AND LIABILITIES OF THE BANKING SECTOR, WHICH COMPRISES ALL BANKS IN THE U.K., THE NATIONAL GIRO, THE DISCOUNT MARKET AND THE BANKING DEPARTMENT OF THE BANK OF ENGLAND, ROSE 209 MILLION POUNDS (S.A.) COMPARED WITH A JANUARY INCREASE OF 184 MILLION POUNDS. THE INCREASE IN LIABILITIES WAS MORE THAN ACCOUNTED FOR BY THE 928 MILLION POUND INCREASE IN OVERSEAS DEPOSITS IN FOREIGN CURRENCIES, AND THAT IN ASSETS BY THE 938 MILLION POUND INCREASE IN LENDING TO THE OVERSEAS SECTOR IN FOREIGN CURRENCIES.

THE BANKING SECTOR'S LENDING TO THE PRIVATE SECTOR FELL BY 306 MILLION POUNDS (S.A.), WHICH IS THE FIRST SIGNIFICANT FALL SINCE MID-MARCH 1976. THE AVERAGE MONTHLY

INCREASE FROM LAST APRIL HAS BEEN ABOUT 345 MILLION POUNDS

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LENDING TO THE PUBLIC SECTOR FELL 38 MILLION POUNDS OVER
FEBRUARY COMPARED WITH A FALL OF 797 MILLION POUNDS IN
JANUARY AND 400 MILLION IN DECEMBER.

3. GDP. PRELIMINARY ESTIMATES ARE NOW AVAILABLE FOR 197
GROSS DOMESTIC PRODUCT BASED UPON THREE DATA SOURCES.
THE ESTIMATE BASED ON EXPENDITURE DATA INCREASED 1.0 PER-
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CENT OVER 1975'S LEVEL IN CONSTANT PRICES, THAT BASED ON INCOME DATA 1.4 PERCENT WHILE THAT BASED ON OUTPUT DATA 0.8 PERCENT. THE COMPOSITE AVERAGE ESTIMATE ROSE 1.1 PERCENT. THE IMPLICIT PRICE DEFLATOR, CALCULATED BY THE EMBASSY BY DIVIDING THE PUBLISHED EXPENDITURE SERIES IN CURRENT PRICES, BY THE SERIES IN CONSTANT PRICES ROSE 14.0 PERCENT.

REAL CONSUMER EXPENDITURE ROSE BUT 0.2 PERCENT, WHILE GROSS DOMESTIC CAPITAL FORMATION FELL 6 PERCENT. IN CONTRAST, THE PUBLIC AUTHORITIES' CURRENT EXPENDITURE ON GOODS AND SERVICES INCREASED 2.8 PERCENT. CONSUMPTION EXPENDITURE GREW AT AN EVEN PACE AS AN AGGREGATE DURING THE LAST HALF OF 1976, ALTHOUGH DRAMATIC METEOROLOGICAL CHANGES LED TO A SHARP DECLINE IN EXPENDITURE ON BEER AND A AND A SHARP RISE IN THAT ON FUEL AND LIGHT IN THE FOURTH QUARTER.

INCOME FROM EMPLOYMENT ROSE 13.9 PERCENT, LESS THAN THE GDP DEFLATOR ROSE. ON THE OTHER HAND, THE GROSS TRADING PROFITS OF PUBLIC (I.E., NATIONALIZED OR GOVERNMENT CONTROLLED) CORPORATIONS GREW 37.7 PERCENT AND OF OTHER COMPANIES 25.7 PERCENT. THE LEVEL OF STOCKS DID NOT CHANGE SIGNIFICANTLY FROM 1975 TO 1976, WITH THE DECLINE OF THE FIRST HALF OF 1976 BEING OFFSET BY A RISE IN THE SECOND HALF.

THE OUTPUT INDICES SHOW NARROW GAINS IN 1976 OVER 1975, EXCEPT AGRICULTURE. FORESTRY AND FISHING WHICH FELL 7.8 PERCENT AND CONSTRUCTION WHICH FELL 4.6 PERCENT. DURING THE FINAL QUARTER OF 1976, HOWEVER, LARGE GAINS WERE RECORDED IN MINING AND QUARRYING AND GAS, ELECTRICITY AND WATER WHICH STOOD 10.1 PERCENT AND 5.8 PERCENT OVER THEIR RESPECTIVE THIRD QUARTER LEVELS.

4. RETAIL PRICES. RETAIL PRICES ROSE MORE SLOWLY IN FEBRUARY. THE INDEX OF RETAIL PRICES (JANUARY 15, 1974 EQUALS 100) STOOD AT 174.1 IN FEBRUARY, A RISE OF 1.0 PERCENT FROM ITS JANUARY LEVEL OF 172.4. AFTER THE SHARP 2.6 PERCENT JUMP IN JANUARY THE FEBRUARY FIGURE CAME AS

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A WELCOME IMPROVEMENT. AS A RESULT THE 12 MONTH RATE OF PRICE INCREASE DECLINED FROM 16.6 PERCENT IN JANUARY TO 16.2 PERCENT IN FEBRUARY. NEVERTHELESS, OVER THE PAST THREE MONTHS RETAIL PRICE INFLATION HAS BEEN RUNNING AT AN ANNUAL RATE OF 20.0 PERCENT. MOREOVER, INCREASES IN INDIRECT TAXATION SUCH AS THE 2 PERCENT PAYROLL TAX ANNOUNCED LAST JULY TO BE IMPLEMENTED ON APRIL 1 AS WELL AS ANY CHANGES TO BE ANNOUNCED IN NEXT WEEK'S BUDGET WILL

NOT PERMIT MUCH IMPROVEMENT IN THE ANNUAL RATE OF PRICE INCREASE OVER THE NEXT FEW MONTHS. R5. WAGES AND EARNINGS. BASIC HOURLY WAGES CONTINUED TO CREEP UP IN FEBRUARY. THE INDEX OF BASIC HOURLY WAGE RATES (JULY 31, 1977 EQUALS 100) STOOD AT 223.9 IN FEBRUARY VIRTUALLY UNCHANGED FROM THE JANUARY FIGURE OF 233.8. WHILE THE INDEX HAS RISEN BY 8.5 PERCENT DURING THE 12 MONTHS THROUGH FEBRUARY, DURING THE 6 MONTHS THAT HAVE ELAPSED SINCE THE SECOND YEAR OF WAGE RESTRAINT BEGAN, THE ANNUAL RATE OF INCREASE HAS DECLINED TO 4.4 PERCENT. IT SHOULD BE NOTED HOWEVER THAT THIS INDEX COVERS ONLY LOWER PAID MANUAL WORKERS MANY OF WHOM ARE MEMBERS OF A UNION WHICH HAS NOT YET RECEIVED ITS SECOND YEAR PAY SETTLEMENT.

THE MORE RELIABLE INDICATOR OF WAGE COSTS IS THE INDEX OF AVERAGE EARNINGS (JANUARY 1970 EQUALS 100) PUBLISHED WITH A DELAY OF ONE MONTH. IN JANUARY THE INDEX OF AVERAGE EARNINGS STOOD AT 277.5, A RISE OF 0.1 PERCENT FROM THE REVISED DECEMBER FIGURE OF 277.1. THIS INDEX HAS RISEN BY 11.8 PERCENT DURING THE YEAR TO JANUARY. HOWEVER, DURING THE 5 MONTHS SINCE AUGUST, IT ROSE BY 5.5 PERCENT. SINCE THE CURRENT POLICY ANTICIPATED A RISE IN AVERAGE EARNINGS OF 7 TO 8 PERCENT, THERE WOULD HAVE TO BE A CONSIDERABLE REDUCTION IN THE RATE OF INCREASE IN AVERAGE EARNINGS OVER THE REMAINING 7 MONTHS OF THE PRESENT YEAR TO MEET THE 7 TO 8 PERCENT TARGET.

6. UNEMPLOYMENT. U.K. UNEMPLOYMENT IN MARCH DECLINED
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FOR THE SECOND CONSECUTIVE MONTH WHILE THE NUMBER OF JOB VACANCIES CONTINUED TO RISE. SEASONALLY ADJUSTED AND EXCLUDING SCHOOL LEAVERS, A TOTAL OF 1.32 MILLION PEOPLE (5.5 PERCENT) WERE REGISTERED AS UNEMPLOYED IN MARCH.

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THIS IS A DECLINE OF 10,300 FROM THE FEBRUARY FIGURE OF 1.3314 MILLION (5.6 PERCENT). THE UNADJUSTED FIGURES SHOW A LARGER DECLINE WITH THE MARCH TOTAL STANDING AT 1.342 MILLION (5.8 PERCENT) COMPARED WITH THE FEBRUARY FIGURE OF 1.380 MILLION (6.0) PERCENT. NOTIFIED JOB VACANCIES ALSO ROSE IN MARCH TO 157.3 THOUSAND A RISE OF 6,800 FROM FEBRUARY. THE IMPROVEMENT IN THE JOBLESS TO-
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TALS IS SOMEWHAT UNEXPECTED GIVEN THE GENERALLY FORECAST LOW RATE OF REAL GROWTH IN 1977. AS A RESULT, THE FEBRUARY AND MARCH FIGURES SHOULD BE TREATED CAUTIOUSLY. IF UNEMPLOYMENT IS IN FACT DECLINING AND 1977 TURNS OUT TO BE A YEAR OF 1 TO 1.5 PERCENT REAL GROWTH, THEN THE PROBABLE CONCLUSION IS THAT U.K. PRODUCTIVITY LEVELS ARE BEING SERIOUSLY ERODED. (FURTHER DETAILS IN SEPTTEL.)

7. THE 1977 ANNUAL REVIEW PUBLISHED BY THE CAMBRIDGE ECONOMIC POLICY GROUP WAS, AS ALWAYS, SHARPLY CRITICAL OF GOVERNMENT ECONOMIC POLICY. REAL ECONOMIC GROWTH OF 5 PERCENT PER YEAR OVER THE NEXT TEN YEARS IS URGED IN ORDER TO REDUCE UNEMPLOYMENT TO AN ACCEPTABLE LEVEL (800,000). THE

GROUP CONTENDS THAT LARGE PUBLIC SECTOR DEFICITS ARE NECESSARY TO PREVENT EVEN WORSE INFLATION AND RECESSION, AND THAT "THE FASHION FOR FISCAL AND MONETARY RESTRICTION, INCLUDING CUTS IN PUBLIC EXPENDITURE, TAKEN UP BY GOVERNMENTS OF INDUSTRIAL COUNTRIES, THE IMF AND MOST COMMENTATORS HAS BEEN THE CAUSE OF CONTINUING WORLD RECESSION." A 2 BILLION POUND TAX CUT AND THE LONG-TERM RESTRICTION OF IMPORTS, BY TARIFFS OR QUOTAS IS URGED AS PART OF AN EXPANSIONARY PROGRAM.

THE GROUP STUDIES A NUMBER OF PROPOSITIONS THAT ARE RELEVANT TO ITS POLICY RECOMMENDATIONS AND ITS CONCLUSIONS RESEMBLE THOSE IT HAS PUBLISHED PREVIOUSLY. IN PARTICULAR IT CONCLUDES THAT THE QUARTERLY GROWTH OF PRICES DOES NOT DEPEND ON A WEIGHTED AVERAGE OF PAST QUARTERLY GROWTH RATES OF M3, NOR DOES IT DEPEND ON A WEIGHTED AVERAGE OF PAST INCREASES IN OUTPUT. RATHER, PRICE INCREASES DEPEND ON INCREASES IN NORMAL COSTS.

8. FINANCIAL MARKETS. INTEREST RATES CONTINUED TO FALL DURING THE WEEK, AND THE BANK OF ENGLAND FOLLOWED AT LEAST PART WAY, BY REDUCING ITS MINIMUM LENDING RATE (MLR) BY 1/2 PERCENT TO 11 PERCENT. THE BANK CONTINUED, HOWEVER, TO EXERCISE ITS RIGHT TO SPECIFY MLR INDEPENDENT

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LY OF THE WEEKLY TREASURY BILL AUCTION RESULT. THE TREASURY BILL RATE BASED FORMULA WOULD HAVE IMPLIED A FULL 1 PERCENT FALL IN MLR TO 10 PERCENT HAD IT BEEN USED. THE MLR DECREASE COULD PRESAGE NEW FALLS IN BANKS' BASE LENDING RATES WHICH POSSIBILITY HAS LED THE BUILDING SOCIETIES ASSOCIATION TO SCHEDULE A DISCUSSION OF MORTGAGE RATE REDUCTIONS AT ITS APRIL 15 MEETING.

A NEW GILT, THE 800 MILLION POUND 12-1/4 PERCENT EX-CHEQUER 1992 WILL BE ISSUED. IT IS PRICED AT 96. YIELDING 12.861 TO REDEMPTION, APPLICATIONS DUE MARCH 24. THE GILT HAS TWO NEW FEATURES. THE FIRST IS THAT ONLY 15 OF THE 96 POUNDS IS TO BE PAID AT APPLICATION, WITH 40 POUNDS MORE PAYABLE ON APRIL 25, AND THE 41 POUND BALANCE PAYABLE JUNE 13. THE GILT WILL TRADE WITH THE FUTURE PAYMENTS LIABILITY ATTACHED, AND THE FIRST INTEREST PAYMENT IN AUGUST TAKES INTO ACCOUNT THE INITIAL SMALL OUTLAYS. THE PURPOSE OF THIS PROVISION IS TO REDUCE THE DISRUPTION TO MONEY MARKETS THAT OCCURRED AT PREVIOUS ISSUES WHEN THE REQUIREMENT THAT 100 PERCENT OF THE VALUE OF THE APPLIED-FOR STOCK ACCOMPANY THE APPLICATION FORCED A REDUCTION IN THE BANKING SECTOR'S LIQUIDITY ON THE ORDER OF 1 BILLION POUNDS FOR A ONE OR TWO-DAY PERIOD. THE GILT SALES NECESSARY TO CONTROL THE GROWTH OF CREDIT IN THE CURRENT FINANCIAL YEAR ARE COMPLETE, SO RECEIVING THE BULK OF PAYMENTS AFTER THE NEW FINANCIAL YEAR BEGINS

APRIL 1 IS ADMINISTRATIVELY CONVENIENT.

THE SECOND FEATURE IS THAT THE NEW GILT'S INTEREST PAYMENTS TO FOREIGN HOLDERS WILL BE NET OF A 35 PERCENT TAX, AS WILL INTEREST PAYMENTS ON FUTURE ISSUES. PREVIOUS ISSUES PROVIDED THAT YIELDS TO FOREIGNERS WERE EXEMPT FROM U.K. TAXES. THE VOLUME OF OUTSTANDING TAX EXEMPT GILTS IS SUFFICIENTLY LARGE THAT THIS MEASURE WILL NOT DETER FOREIGN PURCHASES OF GILTS IN THE MEDIUM TERM. IT SHOULD HOWEVER REDUCE THE LEVEL OF FOREIGN INTEREST IN NEW ISSUES. AND CONSEQUENTLY THE SIZE OF THE APPLICATION FOR NEW ISSUES.

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9. EXCHANGE RATE AND GOLD EFFECTIVE

EXCHANGE RATE			
DATE	EXCHANGE RATE (\$)	DEC. 1971 EQUALS 100)	GOLD (\$)
3/16	1.1795	62.0	147-7/8
3/17	1.7190	62.0	148-7/8

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3/18	1.7172	61.9	149-7/8
3/21	1.7177	61.8	151-7/8
3/22	1.7162	61.8	150-7/8

CHANGE 3/15-3/22 DOWN 0.0028 DOWN 0.2 UP 4-1/4

10. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/16	0.95	2.72	5.22
3/17	0.85	2.52	4.95
3/18	0.97	2.78	5.35
3/21	1.05	3.09	5.75
3/22	1.05	2.85	5.55

CHANGE 3/15-3/22 WIDENED 0.15 WIDENED 0.10 WIDENED 0.10

(ALL FIGURES IN CENTS)

11. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/16	4-5/8	5	5-3/4
3/17	4-7/8	5-1/8	5-1/4
3/18	5-1/8	5-1/8	5-1/4
3/21	4-7/8	5-1/8	5-5/8
3/22	4-7/8	5-1/4	5-1/2

CHANGE 3/15-3/22 UNCHANGED UP 1/8 UNCHANGED

12. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST

RATE DIFFERENTIAL

DATE	
3/16	5-3/16
3/17	4-7/8
3/18	4-21/32
3/21	4-7/8
3/22	4-11/16

CHANGE 3/15-3/22 DOWN 7/16

13. STERLING CERTIFICATES OF DEPOSIT

DATE

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3/16	10-3/16	10-1/16	10
3/17	10-3/32	9-15/16	9-13/16
3/18	9-15/16	9-21/32	9-21/32
3/21	10-9/64	9-7/8	9-7/8
3/22	10-1/16	9-13/32	9-13/32

CHANGE 3/15-3/22 DOWN 1/8 DOWN 3/16 DOWN 1/4

14. THE MINIMUM LENDING RATE WAS REDUCED FROM 11 TO 10-1/2 PERCENT BY THE BANK OF ENGLAND AFTER IT HAD EXAMINED THE RESULTS OF THE MARCH 18 TREASURY BILL AUCTION, AND FOUND THAT THE IMPLIED DECLINE IN A FORMULA COMPUTED MLR WOULD HAVE BEEN EXCESSIVE. THE AVERAGE TREASURY BILL RATE FELL 0.9491 PERCENT TO 9.3520 PERCENT AS THE 300 MILLION POUNDS IN BILLS TENDERED ATTRACTED 1,307.79 MILLION POUNDS IN BIDS. THIS FALL WOULD IMPLY A FORMULA CALCULATED MLR OF 10 PERCENT. THIS WEEK 500 MILLION POUNDS WILL BE TENDERED TO REPLACE 300 MILLION POUNDS MATURING. SPIERS

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